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No. 02-1318

Supreme Court, U.S.
FILED
MAY 13 2003
OFFICE OF THE CLERK

In The

Supreme Court of the United States

ZAPATA HERMANOS SUCESORES, S.A.,

Petitioner,

v.

HEARTHSIDE BAKING COMPANY, INC. d/b/a MAURICE LENELL COOKY COMPANY,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF OF RESPONDENT IN OPPOSITION

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54 pp

QUESTIONS PRESENTED

Respondent submits that the following questions more accurately reflect the issues presented in Zapata Hermanos Sucesores, S.A.'s Petition For A Writ Of Certiorari.

1. Whether the court of appeals in a case of first impression in this country, erred in determining that attorneys' fee awards are not available under the Convention on the International Sale of Goods because: (1) the text and history of the Convention make clear it deals exclusively with substantive matters, while fee awards are a matter of procedural law throughout the world and thus governed by the forum's rules of civil procedure; (2) were never considered by the drafters of the Convention; and (3) their allowance to plaintiffs would produce unintended anomalies?

2. Whether the court of appeals erred in vacating the district court's $550,000 inherent authority, blanket fee award because: (1) it did not specify the alleged misconduct or how it had caused any harm; (2) virtually all the fees that were incurred in this case were caused by the district court's erroneous pre-trial ruling; and (3) the record makes clear that the sanction was imposed based on the defendant's pre-litigation conduct (i.e., not paying), which the district court held could be a basis for a blanket fee award?

3. Whether there is a conflict among the circuits on either issue presented by the Petition For A Writ Of Certiorari?

CORPORATE DISCLOSURE STATEMENT PURSUANT TO SUPREME COURT RULE 29.6

The corporate respondent has no parent, and there are no publicly held companies that hold any stock of the respondent.

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STATEMENT OF THE CASE

A.

A breach of contract claim governed by the Convention On Contracts For The International Sale of Goods ("CISG") was tried in the district court.[1] Plaintiff, Zapata Hermanos Succesores ("Zapata" or "petitioner"), prevailed. The district court awarded the petitioner *all* of its legal fees, totaling $550,000, pursuant to Article 74 of CISG which provides:

> Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of the contract.[2]

The district court also concluded that the inherent authority doctrine justified the blanket fee award.

Defendant, Hearthside Baking Co. Inc. d/b/a Maurice Lenell Cooky Co. ("Lenell"), appealed the fee award.[3] A Seventh Circuit panel, comprised of Judges Posner, Wood and Evans, vacated the entire fee award, (313 F.3d 385),

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[1] CISG, a treaty to which the United States is a signatory, is set forth at 15 U.S.C. App.

[2] Articles 75-78 provide the specific monetary damages that are available in certain instances and along with Article 74 are set forth in the Appendix, *infra* at 1, along with Judge Posner's decision which is reported at 313 F.3d 385 (7th Cir. 2002). (App. *infra* at 4).

[3] Lenell's appellate counsel did not participate in the trial of the underlying case.

and the court denied unanimously a petition for rehearing en banc. Writing for the unanimous panel, Judge Posner concluded that "the convention is about contracts not procedure," and thus because the recoverability of attorneys' fees is a procedural matter, it is governed by the forum's procedural rules. This is consistent with CISG explicit recognition that CISG deals exclusively with substantive provisions of law. *See*, Argument I, *infra*. In federal courts, the applicable procedural rule is the "American Rule" which does not allow for the recovery of attorneys' fees. 313 F.3d at 388.

Judge Posner rejected Zapata's interpretation of Article 74 for two additional reasons. First, construing it to allow for the recovery of attorneys' fees incurred during litigation would produce "anomalies" not uniformity, as Zapata has claimed. (Petition at 9-19).

> The interpretation of 'loss' for which Zapata contends would produce anomalies, which is another reason to reject the interpretation. On Zapata's view the prevailing plaintiff in a suit under the Convention would (though presumably subject to the general contract duty to mitigate damages, to which we referred earlier) get his attorneys' fees reimbursed more or less automatically (the reason for the "more or less" qualification will become evident in a moment). But what if the defendant won? Could he invoke the domestic law, if as is likely other than in the United States that law entitled either side that wins to reimbursement of his fees by the loser? Well, if so, could a winning plaintiff waive his right to attorneys' fees under the Convention in favor of domestic law, which might be more or less generous than Article 74 . . . . 313 F.3d at 388-389.

Second, he rejected it because "[t]o the vast majority of the signatories of the Convention, being nations in which the loser pays is the rule anyway, the question whether loss

includes attorneys' fees would have held little interest; there is no reason to suppose they thought about the question at all." 313 F.3d at 391.

This sound determination does not warrant review. First, there is no division among the circuits over whether Article 74 allows for the recovery of attorneys' fees. The Seventh Circuit is the first appellate court to address this issue. This alone warrants denial of the Petition. *See McCray v. New York*, 461 U.S. 961, 963 (1983) (Stevens, J.) (*Certiorari* denied where the issue requires further study in the lower courts before it is addressed by this Court). Conflict with a handful of international decisions (many of which were arbitration panels) does not warrant *certiorari* because "[t]he Court is only interested in conflicts which its decision in a particular case will remove." Frankfurter and Hart, *The Business of the Supreme Court at the October Term*, 1933 Harvard L. Rev. 238, 268 (1934). *Accord* 23 Moore's Federal Practice § 510.21[3][a] (3d ed. 1991). Here, there is no such type of conflict because the Supreme Court has no authority over foreign tribunals. *Cf.* 23 Moore's Federal Practice, *supra* at § 510.22[2] (the Court refuses to hear matters of state law where no federal issue is involved because of "its inability to compel states to follow its decision").

Second, Judge Posner's determination that attorneys' fees are not recoverable under Article 74 only effects the small number of CISG cases tried in the United States. Throughout the rest of the world, attorneys' fees can be recovered pursuant to the forum's procedural codes. *See* Argument I, *infra*. As there have been very few CISG cases of any kind in the United States[4] and none involving

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[4] *See Delchi Carrier SpA v. Rotorex Corp.*, 71 F.3d 1024, 1028 (2nd Cir. 1995) (virtually no CISG "caselaw exists").

attorneys' fee, debate over the availability of attorneys' fee awards does not warrant this Court's review. "[A]cademic or episodic debate" does not warrant the granting of *certiorari*. *Rice v. Sioux City Cemetery*, 349 U.S. 70, 74 (1955).

Judge Posner also reversed the inherent authority award, concluding that an inherent authority fee award "is a residual authority to be exercised sparingly, to punish misconduct (1) occurring in the litigation itself, not in the events giving rise to the litigation (for then punishment would be a product of substantive law . . .), and (2) not adequately dealt with by other rules, most pertinently here Rules 11 and 37 of the Federal Rules of Civil Procedure, which Lenell has not been accused of violating." 313 F.3d at 391. The court below also made clear that any "fault here was in no small measure the judge's" for failing to grant defendant's partial summary judgment motion. The Petition does not challenge this conclusion. On remand, the court of appeals reassigned the case in accordance with Seventh Circuit Rule 36 because of the district court's deprecatory treatment of Lenell and its counsel. 313 F.3d at 391-392.

Judge Posner's determination that the district court's inherent authority fee award was improper is in conformity with *Chambers v. NASCO*, 501 U.S. 32 (1991). The Petition's claim that there is a split in the circuits over the "meaning" of *Chambers* (Petition at 22-29) is plainly wrong. *Chambers* held that:

> [W]hen there is bad faith conduct in the course of litigation that could be adequately sanctioned under the Rules, the court ordinarily should rely on the Rules rather than the inherent power. But if in the informed discretion of the court, neither the statute or Rules are up to the task, the court may safely rely on its inherent authority. *Id.* at 50-51.

The opinion below says precisely the same thing. An inherent authority fee award is to address wrongs "not adequately dealt with by other rules, most pertinently here Rules 11 and 37 of the Federal Rules of Civil Procedure." 313 F.3d at 391. Authorities from the other circuits are in accord with this aspect of *Chambers*.

Chambers also held that "the imposition of sanctions under the bad-faith exception depends not on which party wins the lawsuit, but on how the parties conduct themselves during the litigation." 501 U.S. at 44, 53. Judge Posner's opinion reiterates the principle. An inherent authority fee award is to address conduct "occurring in the litigation itself, not in the events giving rise to the litigation." 313 F.3d at 392. This is the "uniform view among the circuits." *Association of Flight Attendants, AFL-CIO v. Horizon Air Industries, Inc.*, 976 F.2d 541, 548-49 (9th Cir. 1992).

In sum, there does not exist a conflict let alone an "important conflict" among the circuits over the meaning of *Chambers* that "create[s] an intolerable conflict among the nation's lower courts" and warrants this Court's review of Judge Posner's decision. S. Baker, *A Practical Guide to Certiorari*, 33 Catholic Univ. L. Rev. 611, 617 (1984). *See also* Supreme Court Rule 10(a). The Petition should be denied.

B.

Maurice Lenell is a small, family owned, commercial wholesale baker, which since 1937 has been selling cookies to institutional buyers. By at least mid March 1998, there was a dispute concerning how much Lenell owed Zapata,

one of its suppliers. (Tr. 69-70).[5] The parties had several meetings and phone calls to resolve their difficulties. They could not agree on what was owed, (Tr. 149, 171-178, 184-200, 372, 539, 617), although Lenell's books showed several hundred thousand dollars were owed, and Lenell's CEO estimated Zapata was owed between $400,00 and $500,000. As so often happens in these kinds of cases, the parties had differing views of what occurred and of their rights and responsibilities. Zapata threatened to stop all shipments without payment in full; Lenell responded that former suppliers do not have the same priority as present ones. (Tr. 84, 315, 323, 539).

Zapata then sued under CISG. (R. 1). After a trial, the court awarded Zapata[6] judgment for $857,796.90, as a matter of law. (Tr. 863-866). The jury awarded Zapata interest in excess of $300,000, and denied any recovery on Lenell's counterclaim. (R. 65-67). After Zapata prevailed on its approximately $900,000 breach of contract claim, it sought an attorneys' fee award under Article 74 of CISG. (R. 66). Lenell objected. (R. 92). In August 2001, the court concluded that Zapata was entitled under Article 74 to recover *all* its fees, totaling $550,000. This was the court's reasoning: (1) attorneys' fees are a "foreseeable" "consequence" of breaching a contract; (2) attorneys' fees are recoverable in most countries that have ratified CISG; and (3) several foreign decisions have awarded attorneys' fees under CISG. (R. 94; Appendix). The district court was apparently unaware that fee awards are everywhere a matter of procedural law.

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[5] The citations are to the trial transcripts ("Tr.") and the record ("R.") below.

[6] Plaintiff was not, as is claimed in the Petition, a small owned manufacturer. It is part of a huge international corporation.

The alternative basis for the imposition of the massive, blanket fee award was the court's inherent authority, which, the court held, allows sanctions for a party's "pre-litigation *or* litigation conduct *or both*," and that Lenell's conduct "*both leading up* to and during the litigation supports an award of attorneys' fees pursuant to the inherent power doctrine. . . ." (R. 95) (Emphasis supplied). The pre-litigation conduct was Lenell's failure to pay the amounts that were not reasonably in dispute; the litigation conduct was the continuing failure to pay those amounts and the filing of an Answer that denied "*any* liability." (R. 95 at 5). The court identified no other conduct, and its findings consisted of the attachment and incorporation of two pages of Zapata's memorandum in support of its request for fees. (R. 95 at 11). There was no claim that Lenell's counterclaims were made in bad faith or that the litigation as it pertained to them or the disputed portions of Zapata's claims were sanctionable. Nor was there any attempt by either Zapata or the district court to allocate how much of the total fees were attributable to the Answer or the non-payment.

Lenell's Answer to the Complaint (R. 5) denying liability could not authorize sanctions for *all* the fees incurred in the case. Lenell's responses to requests to admit in November, 1999, three months after the Answer had been filed, admitted facts giving rise to liability of $857,000, "as a matter of law" – according to Zapata's own filings in the district court. (R. 27 at 1, 8, R. 28 at 5, ¶¶ 28-43; Tr. 863-866). Although the district court had concluded before trial that these responses "acknowledged the very substantial amount that is due" (R. 55-3 at 11), it ignored their existence and effect on the case in awarding Zapata its fees for the *entire* litigation. And it ignored the effect this early admission had on the conclusion that the offending (to the Court) Answer justified the blanket fee award.

Yet, less than $15,000 in fees was expended to this point to secure these admissions. The balance of the claimed indebtedness which continued to be disputed was a proper subject for trial. Indeed, the district court recognized that even if Lenell had paid what was undisputed, "[t]his litigation would still have proceeded in that event." 155 F.Supp.2d at 972. Half of the trial transcript is occupied by proceedings related to the defense case, counter claim, jury instructions conference, closing arguments, jury instructions, and related matters. They were that part of the trial that would have occurred regardless of the Answer or payment. Nonetheless, the district court even awarded *all* the fees pertaining to this half of the proceedings.

Apart from the obvious fact that the mass of indesputably relevant evidence on all the issues went to the jury and occupied so much trial time was not sanctionable, the court itself recognized that the trial had been dramatically lengthened by the lawyers for both sides, who had given "insufficient thought to what the trial is all about." "Real thought," the district court lamented, would have gotten the trial over in 2½-3 days. (Tr. 802-803). Zapata's lawyers in this court were counsel in the district court. Ineptitude and thoughtlessness are not a basis for any fee sanction under the inherent authority doctrine or any other doctrine.

The district court made no attempt to determine how much of the plaintiff's case resulted from the denial in the Answer and/or the non-payment and ignored the responses to requests to admit, which effectively admitted virtually all of what was owed. That "acknowledg[ment]" precludes a sanction award that exceeds the cost of securing the admissions. *Smith v. Chicago Reform Board of Trustees*, 165 F.3d 1142, 1147 (7th Cir. 1999). Without an appropriate finding of causality between the harm and the offending conduct, any fee award is improper.

For the district court, Lenell's non-payment was an unpardonable ethical breach: "legitimate," "responsible business people" pay their debts. If they do not, the court concluded, they can be punished under a court's inherent authority. Put another way, "stiffing" a creditor – an epithet of which the district court was fond (R. 55-3 at 5; R. 94 at 5; Tr. 328, 862) – is "bad faith" warranting blanket punishment. The court remanded the case because – contrary to the Petition's assertion – the district made no supportable findings of bad faith that would warrant an inherent authority attorney fee award. "Since the challenged award of $550,000 in attorneys' fees cannot stand, we need not pick through the record to see whether some of the counterclaims or other moves by Lenell during the trial were sanctionable. . . . " 313 F.3d at 391.

REASONS FOR DENYING THE WRIT

I.

CISG DOES NOT PROVIDE FOR AN AWARD OF ATTORNEYS' FEES

A.

CISG's drafters did not intend to deviate from the world consensus that attorneys' fee awards are a procedural matter governed by the procedural rules of the forum or to abrogate its signatory nations' rules of civil procedure. CISG's Introduction stresses that CISG "sets out substantive provisions of law;" it "'d[id] not [intend to] interfere with [procedural] domestic rules.'" (Introduction CISG, 15 U.S.C. App.)[7]

[7] *Accord* Harry Fletchner, *Recovering Attorneys' Fees As Damages Under The U.N. Sales Convention: A Case Study On The New International Commercial Practice And The Role Of Foreign Case Law In CISG*

(Continued on following page)

"[P]rocedural matters . . . remain within the province of national law, and procedural conceptions may still serve as covert limitations on CISG consequential damage awards." Eric Schneider, *Consequential Damages in the International Sale of Goods: Analysis of Two Decisions*, 16 University of Pennsylvania Journal of International Business, 615 (1995) (citing Joseph M. Lookofsky, Consequential Damages in the Comparative Context 189, 238 (1989)).

In *MCC-Marble v. Cermaica Nuova D'Agostino, S.P.A.*, 144 F.3d 1384 (11th Cir. 1998) (Petition at 12), the court concluded that *CISG*'s parole evidence rule governed the parties' dispute. *MCC-Marble* also stressed that the *forum's* procedural rules would govern the dispute. 144 F.3d at 1389, n.13.

Throughout the world, the availability of an attorneys' fee award is a procedural matter governed by the forum's code of civil procedure, not by its substantive laws. The European community has concluded that as a matter of policy a loser-pays rule is in society's best interest, and European states' codes of civil procedure contain fee shifting rules. For example, Section 91 of the German Code of Civil Procedure provides that "the losing party bears the costs of the lawsuit." The Swedish loser-pays

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Jurisprudence With A Post-Script On Zapata Hermanos Sucesores S.A. v. Hearthside Baking Co., 22 Northwestern Journal of International Law & Business 121 (2002); Joseph Lookofsky, *Zapata v. Hearthside Baking, 6* Vindbona Journal of International Comm. Law 27-29 (2002); Harry Flechtner, *The U.N. Sales Convention (CISG) and MCC-Marble Ceramic Center, Inc. v. Ceramica Nuova D'Agostino, S.P.A.: The Eleventh Circuit Weighs in on Interpretation, Subjective Intent, Procedural Limits to the Convention's Scope, and the Parole Evidence Rule;* 18 Journal of Law and Commerce 259 n.136 (1999); Amy Kastely, *The Right to Require Performance in International Sales,* 63 Wash. L. Rev. 607 (1988).

provisions are found in Chapter 18:1 and 18:8 of the Swedish Judicial Code of Civil Procedure. The French loser-pays provisions are found in the new Code of Civil Procedure, Articles 695 and 696. The Danish loser-pays provisions are found at § 312 of the Danish Code of Civil Procedure. The English loser-pays rules are found in similar statutory and procedural enactments and are derived from the Statute of Gloucester. *See Fleischman v. Maier Brewing Co.*, 386 U.S. 714, 717 (1967).

The United States has made a different policy judgment concerning the recoverability of attorneys' fees. *Alyeska Pipeline Service Co. v. The Wilderness Society*, 421 U.S. 240, 257 (1975). In the United States, however, like the rest of the world, attorneys' fees are considered a "cost," (not a component of damages) whose recovery is governed by procedural rules. *See* Rule 54(d)(1), Federal Rules of Civil Procedure ("costs, other than attorneys' fees shall be allowed as of course"); *In re Paoli R.R. Yard PCB Litigation*, 221 F.3d 449, 457-458 (3rd Cir. 2000); 10 Wright, Kane & Miller, Federal Practice and Procedure § 2665, at 199-200 (3d ed. 1998).

Recognition of these principles does not mean that Judge Posner was construing CISG by using domestic law (Petition at 13). Unlike the Petition, the court below began with a question not with an answer.

In *Conte v. Flota Mercante Del Estado*, 277 F.2d 664, 671 (2nd Cir. 1960), Judge Friendly addressed the availability of an attorney fee award pursuant to the laws of another nation which governed the parties' dispute. Consistent with Judge Posner's conclusion, Judge Friendly held that attorneys' fees could not be recovered under the foreign nation's law because the availability of attorneys' fees is a matter of procedural not substantive law. Obviously, *Conte* amply supports the decision below. Although cited in the brief below, Zapata ignored Judge Friendly's decision and continues to do so here.

Alyeska Pipeline Service v. Wilderness Society, 421 U.S. 240, 259, n.31 (1975) and *Chambers*, *supra*, 501 U.S. at 53 (Petition at 17 n.7) are not at odds with all these authorities and the Rules. *Alyeska Pipeline Service* and *Chambers* held that the availability of attorneys' fees is substantive, but only *for diversity purposes*. This simply means that the determination as to whether or not the availability of attorneys' fees are procedural or substantive is determined by examining whether or not fee awards are procedural under the laws of the forum state when the federal court is sitting in diversity jurisdiction. "[E]ven though attorneys' fees are substantive for diversity purposes, they are not necessarily substantive under [the forum state's] choice of law rules." *Midwest Grain Products v. Productization Inc.*, 228 F.3d 784, 791 (7th Cir. 2000). *Accord Boyd Rosene & Assoc. v. Kansas Municipal Gas Agency*, 174 F.3d 1115, 1118 (10th Cir. 1999).

Here, the district court had subject matter jurisdiction pursuant to 28 U.S.C. § 1331 over Zapata's claims, and the applicable federal procedural rules do not allow for the recovery of attorneys' fees. Moreover, even if the claim had been predicated on diversity jurisdiction, 28 U.S.C. § 1332, a fee award would still be unavailable, because under the forum's law (Illinois law), attorneys' fee awards are a matter of procedural not substantive law, and are barred by the American Rule. *Midwest Grain Products v. Productization Inc.*, *supra*, 228 F.3d at 791.[8]

[8] Numerous other states also view attorneys' fee awards as a matter of procedural not substantive law. *See e.g. Bell v. City of Kellogg*, 922 F.2d 1418, 1425 (9th Cir. 1991) (Idaho).

B.

Zapata's insistence that unless Article 74 is deemed to include attorneys' fees, the uniformity sought by the Convention will be lacking, begs the question to be decided. First, uniformity is a goal of CISG – but uniformity only as to the *substantive* rights and obligations of contracting parties. The text and history of CISG make clear that the drafters of CISG did not intend to interfere with *procedural* domestic rules. Whether CISG's substantive rights and obligations include the payment of attorneys' fees depends on whether they were intended to constitute "losses" under Article 74. Question begging cannot answer that question.

Second, it is no answer to say that attorneys' fees are necessary to make a successful plaintiff "whole." This argument also begs the question to be decided. Since attorneys' fees are available everywhere under codes of civil procedure, except in the United States, it does not follow that CISG's drafters must have intended that Article 74 require an award of attorneys' fees as a component of "losses." Nor does it follow that absent a fee award under CISG a prevailing plaintiff cannot be made "whole." For example, the New York Court of Appeals has held that despite the constitutional requirement of just compensation, the takings clause does not require an award of attorneys' fees in order to make the plaintiff whole. *City of Buffalo v. J.W. Clement Co.*, 28 N.Y.2d 241, 269 N.E.2d 895 (1971).

C.

The structure, legislative history, and operative effects of CISG demonstrate that Article 74 was not intended to include attorneys' fees. Article 77 mandates that a plaintiff must "mitigate the loss . . . resulting from the breach," and that the party in breach "may claim a reduction in the damages in the amount by which the loss should have

been mitigated." Obviously, the word "loss" does not have a different meaning in Article 77 than it does in Article 74. If attorneys' fees are a component of loss under Article 74, a defendant would be entitled to have a jury determine whether the plaintiff had mitigated the "loss" by conducting the litigation in the most cost effective way. Since that determination could not be made until after the case was over – for the fees would not be known until then – loss cannot encompass attorneys' fees.

Professor Farnsworth has observed that the Article 70 of the prior CISG, whose language is identical to the current Article 74, comes "close to blending the Restatement of Contracts § 330, which allows recovery for 'injuries that the defendant had reason to foresee as a probable result of his breach when the contract was made,' and UCC 2-715(2)(a), which allows the buyer recovery for 'any loss resulting from general or particular requirements and needs of which the seller at the time of the contracting had reason to know.'" Allen Farnsworth, 27 American Journal of Comparative Law 259 (1979). Although the UCC is not per se applicable, "UCC may inform the court where the language of the relevant CISG provision tracks that of the UCC." *Delchi Carrier SpA v. Rotorex Corp.*, *supra*, 71 F.3d at 1028.

Neither the Restatement of Contracts § 330 nor UCC 2-715(2)(a) allows for the recovery of attorneys' fees. It is idle to suggest that Article 74 requires an attorney fee award when the Restatement and the UCC, from which it is derived, do not allow for the recovery of attorneys' fees. A contrary conclusion would run afoul of the basic rule of statutory construction that "absurd" statutory constructions are to be avoided. *Public Citizen v. United States Department of Justice*, 491 U.S. 440 (1989); *Green v. Bock Laundry Machine Co.*, 490 U.S. 504, 527 (1989) (Scalia, J., concurring).

CISG's legislative history confirms that attorneys' fees are not available under Article 74:

> Referring to the *travaux pre'paratories* of the CISG . . . it appears that those who drafted and approved the final text of the Convention never indicated that Article 74 encompassed damages for the prevailing party's attorneys' costs – a significant omission given the lack of international consensus on the recovery of such costs. Indeed, from the formal records of the history of CISG it appears that the subject of recovering attorneys' fees never arose during the drafting and negotiation of the treaty. This strongly suggests that the United States and other countries that generally require litigants to bear their own attorneys' fees did not expect or intend that the CISG would change such a significant aspect of the litigation process. Flechtner, *supra*, 151.

Reading Article 74 to allow for attorneys' fees would result in a dramatic disparity in treatment among litigants. Since recovery of "loss[es]" is limited to those proving a contractual breach, only prevailing plaintiffs, but not prevailing defendants, could obtain a fee award. This approach not only abrogates the American rule in the United States, it would abrogate the loser-pays rule prevalent throughout Europe. Such an approach would jettison the two systems prevailing throughout the world in favor of a new approach that only allows prevailing plaintiffs to recover fees.

There is nothing in the history of CISG to suggest that its drafters intended such nonuniform treatment of plaintiffs and defendants, and nothing to suggest that CISG's signatories would have adopted so disruptive and far reaching a rule without any mention in CISG's text or legislative history that they intended so profoundly to restructure the existing framework. Judge Posner put it this way: "To the vast majority of the signatories of the

Convention, being nations in which the loser pays is the rule anyway, the question whether loss includes attorneys' fees would have held little interest; there is no reason to suppose they thought about the question at all." 313 F.3d at 391.

It would be equally absurd to suggest that Article 74 was intended to apply only as a matter of substantive law to prevailing plaintiffs, while relegating prevailing defendants to the forum's procedural law, with all its restrictions and local peculiarities. Such a forced construction would also result in a regime of unequal treatment, with the outcome dependent upon where the case was being litigated. Absent proof of the most compelling sort, it cannot be concluded that Article 74's drafters intended to introduce into CISG these uncertainties, inequalities, and incentives for forum shopping. Statutory construction requires an assessment of the real world situation to which the language applies.

Finally, a footnote to the 1978 Commentary to Article 70, which mirrors the language of Article 74, states that the time for measuring "loss" should be at "an appropriate [one] such as the moment the goods were delivered, or the moment the buyer learned the non-conformity would not be remedied by the seller under other articles of the convention." Jeffrey Sutton, *Measuring Damages Under The United Nations Convention On The International Sale Of Goods*, 50 Ohio State L.J. 742 (1989) (citing Commentary on the Draft Convention on Contracts for the International Sale of Goods, Prepared by the Secretariat, 70, n.2 U.N. Doc. A/CONF. 97/5 (1979). Obviously, measuring the loss at either of these times results in the exclusion of attorney's fees as a component of "loss."

D.

All the Petition offers is a superficial, overly simplistic, and incorrect analysis of whether Article 74 allows plaintiffs to recover attorneys' fees. It adverts to the

existence of 275 foreign CISG cases – the inference – whether intentional or inadvertent – is that all hold that attorneys' fees are recoverable under Article 74. (Petition at 4, 11). However, only a handful of these cases have addressed the availability of attorneys' fees under Article 74, as demonstrated by the fact that Zapata only relied on a limited number of cases that ostensibly had held that attorneys' fees were recoverable under Article 74 in the court below.

Case No.17U146\93(OLG Dusseldorf 1/14/94) (Petition at 10) did not hold that post-lawsuit attorneys' fees are recoverable under Article 74. There, the plaintiff was only awarded its *pre-lawsuit* attorneys' fees under CISG. The remainder of its fees were awarded pursuant to the German Code of Civil Procedure's fee-shifting provisions. In imposing post-litigation fees as a procedural matter under local law, the court in Dusseldorf acted consistently with other German courts that have done the same thing. *See also* Flechtner at 129-131.

Zapata's two other authorities are similarly distinguishable. (R. 73 at 4, Ex. 4, 5; R. 94) In the first (R. 73, Ex. 3), the court primarily relied on and "discussed at far greater length than the holding based on CISG Article 74 . . . an interpretation of the parties' contract, as including an implied term requiring a breaching party to pay such compensation." Fletchner, *supra* at 129-131. The second decision (R. 73, Ex. 5) was rendered by a German petty court, and its summary was less than a half page long. These two opinions hardly constitute a uniformity of decision in favor of awarding "fees under Article 74. Moreover, judicial opinions are not fungible; they "do not have equal intrinsic authority." *Adamson v. California*, 332 U.S. 46, 59 (1947). In the cases relied on by Zapata, there was not the careful

analysis required before any court should rely overmuch on them.[9]

Air France v. Saks, 470 U.S. 392, 400 (1985) (Petition at 9) held that foreign decisions should be consulted to assure that the "specific word" in a treaty is construed "consistent with the *shared expectations of the parties*." (Emphasis supplied). Here, as Judge Posner showed, there are no "*shared expectations*" of CISG's signatory nations. 313 F.3d at 389.

In *Air France*, particular attention was given to the French interpretation of the word "accident" because the treaty was drafted in French. The Court, however, stressed that the "negotiating history of the Convention, the conduct of the parties to the Convention . . . and [the treaty's legislative history]," are "proper" sources to refer to when interpreting a treaty, and that *each* supported the statutory construction adopted by the Court. This Court made clear that it was not bound by French courts' decisions just because they had spoken first: We are not "forever chained to French law by the Convention." 470 U.S. 399-401. Rather, French decisions were interpretative tools. Here, all the sound interpretive tools lead to the

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[9] Professor Fletchner discussed other authorities which held that fees are recoverable under Article 74. One involved a default judgment, which due to its one sided nature is not conducive to a comprehensive and informed consideration of the issues. *Cf. Adamson v. California*, 332 U.S. 46, 59 (1947) (Frankfurter, J., concurring). The decision also contained only a cursory analysis of the issue. Fletchner, *supra*, at 129-131. Another case is an arbitration panel decision, and "it is not entirely clear what is included in the damage award." Fletchner, *supra*, at 129-131. Arbitration decisions are not particularly persuasive, given their nature. Tellingly, the Petition only cites two authorities that were not cited in the courts below for the proposition that Article 74 authorizes attorneys' fee awards. One is another arbitration panel decision (Petition at 11 n.5), the other is another laconic German decision predating Judge Posner's decision. (Petition at 11).

inescapable conclusion that Article 74 does not allow for the recovery of attorneys' fees.

The literature does not "strongly" support Zapata's position, either. (Petition at 11). Indeed, it does not support it at all. Professor Fletchner's article, *supra*, concluded that the district court's decision was "clearly incorrect," and a "misconstruction of Article 74." Professor Fletchner has authored at least 10 articles on the Convention. Professor Lookofsky has also concluded that the district court's determination that Article 74 allows for the recovery of attorneys' fees was not correct. Joseph Lookofsky, *supra*. Professor Lookofsky of the University of Copenhagen is recognized as one of the preeminent authorities on CISG and has authored over 25 articles and treatises on CISG. Both articles discuss at length the procedural nature of attorneys' fees awards, and their nonavailability under CISG.

In contrast, the two main authors on whom the Petition relies (Petition at 11-12) do nothing more than parrot the district court's decision. Each fails to address the procedural nature of attorneys' fees, the "anomalies" that reversal of this case would create, and offers little more than a vote in favor of the district court's analysis. *See* Felemegas, *An Interpretation of Article 74 CISG by The U.S. Circuit Court of Appeals*, to be published in 15 Pace Int'l L. Rev. (Spring 2003); Schlechtriem, *Attorneys Fees As Part Of Recoverable Damages*, 14 Pace Int'l L. Rev. 205 (2002). Neither begins to rebut Judge Posner's careful exegesis of Article 74, which has yet to be addressed by foreign or domestic courts, and thus is not yet ripe for review. *McCray v. New York*, *supra*, 461 U.S. at 963.

Finally, a third article cited by the Petition purports to criticize Judge Posner's decision, but agrees that while "awarding attorneys' fees as damages is in conflict with the majority of the world's legal systems," "the Appellate

Court correctly states that the District Court's interpretation of loss in the context of Article 74 would produce anomolies," and agrees that Judge Posner's decision was correct! Jarno Vanto, *Attorneys' Fees As Damages In International Commercial Litigation*, 15 Pace Int'l L. Rev. (Spring 2003). This is scarcely "strong support" for Zapata.

II.

THE DISTRICT COURT'S IMPOSITION OF $550,000 IN ATTORNEY'S FEES UNDER ITS INHERENT AUTHORITY WAS IMPROPER

A.

The record makes clear that the district court resorted to the doctrine of inherent authority because of its dissatisfaction with the "American Rule," which is applicable to contract breaches, *West Lafayette Corp. v. Taft Contracting*, 178 F.3d 840, 844 (7th Cir. 1999), and which prohibits recovery of attorneys' fees in the absence of a statute or contract provision allowing them. The district court lamented that the American Rule does "*not* make prevailing parties truly whole by saddling their adversaries with the winners' legal expenses – an omission that does not . . . put the winners in contract disputes into the same economic position as if they had performed their required obligations under contracts. . . . " (R. 95, Mem. Op. 2-3). To escape the American Rule and to make Zapata whole, the court invoked its "inherent authority." (R. 95 at 12). The only conflict in this case is that between the district court's decision and the uniform decisions of the circuit court of appeals.

The district court's sanctions opinion was unfaithful to *Chambers'* threshold imperative that "[b]ecause of their very potency, inherent powers must be exercised with restraint and discretion." 501 U.S. at 44. All the circuits have stressed that this principle of restraint must guide

analysis. *See e.g. Montrose Medical Group v. Bulger*, 243 F.3d 773, 784 (3rd Cir. 2001). The inherent authority doctrine is further constrained by the requirement that the court *find* that "fraud has been practiced upon it or the very temple of justice has been defiled." *Chambers*, *supra*, 501 U.S. at 46. The court below made no such findings, and its conclusory pronouncements did not approach this "extremely high" standard. *Goldin v. Bartholow*, 166 F.3d 710, 722 (5th Cir. 1999).

Only literary perversity or jaundiced partisanship could suggest that Lenell's Answer or its failure to pay was a "fraud" on the court or defiled the temple of justice. Far from being deceived about the case, the court was so informed about it that it excused the parties from the requirement, if there was to be a bench trial, of submitting the usual pretrial order, noting: "There's no mystery about this one on either side." (R. 55-4 at 3-4). Moreover, in light of Rule 16, Fed. R. Civ. P., which the court said it could employ (R. 55-3 at 2-3) – but did not – the portion of the very substantial amount "acknowledged" to be owed could effectively have been removed from the "temple" quicker than Ananias and Sapphira. Acts 5:1-12.[10] Indeed, Judge Posner concluded that the district court's failure to grant partial summary judgment was the cause of much of the harm that Zapata professes to have suffered. 313 F.3d at 391. ("But as it happens, the fault here, was in no small measure the judge's").

A further limitation on the inherent authority doctrine is that the fraudulent conduct must occur during the litigation, since a "primary aspect" of the court's inherent

[10] Of the approximately $1,000,000 damage award (exclusive of interest) the district court conceded that within 3 months of the Answer, Lenell had effectively admitted $850,000 through answers to request to admit. *See* Statement of the Case, *supra*.

authority "is the ability to fashion an appropriate sanction for conduct which abuses the judicial process. * * * [T]he imposition of sanctions under the bad-faith exception depends not on which party wins the lawsuit, but on how the parties conduct themselves during the litigation." *Chambers*, 501 U.S. at 44, 53. The district court nonetheless held that pre-litigation conduct could suffice, and thus looked to Lenell's purported "stiffing" that preceded the lawsuit. But that is the same conduct the court found so objectionable after the suit was filed.

This holding was contrary to "[t]he uniform view among the circuits" that inherent power to award fees for bad-faith conduct "does not extend to the conduct upon which the suit is based." "Expansively applied, the bad faith exception risks conflict with the rationale of the American rule and hence should be construed narrowly." *Association of Flight Attendants, AFL-CIO v. Horizon Air Industries, Inc., supra*, 976 F.2d at 548-49 (9th Cir. 1992). Incredibly, the Petition has cited this case for the proposition that inherent authority attorney fee awards may be based on the conduct that forms the basis of the lawsuit. (Petition at 26, 27). Judge Posner's conclusion on this point is consonant with the decisions of the other courts of appeals and with *Chambers*.

In *Morganroth & Morganroth v. DeLorean*, 213 F.3d 1301, 1318 (10th Cir. 2000), a judgment creditor sued to set aside a fraudulent transfer and was granted summary judgment as well as attorneys' fees under the court's inherent power "based on the fraudulent nature of the transfer, as opposed to the conduct of the litigation itself." *Id.* at 1308. There, as here, the district court was incensed at the debtor "having done everything possible to avoid honoring just debts." 213 F.3d at 1316. The court of appeals reversed because the sanction was not based on the conduct of the litigation, but on "the underlying previous

conduct which gave rise to the cause of action . . . . " *Id.* at 1317. The court stressed that:

> Among the reasons given for the limitation is that a contrary rule would constitute a substantial abridgement of the American Rule. . . . A defendant found liable for fraud, for instance, would automatically be guilty of bad faith with respect to the underlying cause of action, thus abrogating the American Rule in all successful fraud actions. Such complete abrogation is not the purpose of the bad faith exception. *Id.* at 1318.

In *United States v. Fidelity & Deposit Co.*, 986 F.2d 1110, 1120 (7th Cir. 1993), the Seventh Circuit recognized that the "during the litigation" requirement protects against the danger of encroaching upon substantive law.

The other circuits have also recognized that only litigation conduct can be sanctioned under the inherent authority doctrine. *See Goldin v. Bartholow*, 166 F.3d 710, 722 (5th Cir. 1999); *Shimman v. Int'l Union of Operating Engineers*, 744 F.2d 1226, 1233 (6th Cir. 1984) (en banc) (Petition at 27) (to allow "an award of attorneys' fees based on bad faith in the act underlying the substantive claim would not be consistent with the American Rule"); *Lamb Engineering & Construction Co. v. Nebraska Public Power District*, 103 F.3d 1422, 1435 (8th Cir. 1997) (Petition at 26) (reversing sanctions under inherent authority based on defendant's "bad faith" breach of contract, since this was "pre-litigation conduct" that was part of the underlying substantive claim); *McLarty v. United States*, 6 F.3d 545, 548 (8th Cir. 1993) (same); *Towerridge, Inc. v. T.A.O., Inc.*, 111 F.3d 758, 769 (10th Cir. 1997) (Petition at 27) (expansion of bad-faith exception to pre-litigation conduct "risks swallowing the Rule" and is "not warranted by the exception's purpose, nor authorized by its source"); *Woods v. Barnett of Fort Lauderdale Bank*, 765 F.2d 1004, 1014

(11th Cir. 1985); *Amsted Industries, Inc. v. Buckeye Steel Castings Co.*, 23 F.3d 374, 378 (Fed. Cir. 1994); 10 Moore's Federal Practice § 54.171[2][c][ii] at p. 54-266 ("we believe . . . that a finding of bad faith may only be based on conduct relating to the litigation"); 1 Mary Francis Derfner & Arthur D. Wolf, Court Awarded Attorneys' Fees ¶ 4.01[2] (1999).

The Petition's assertion that three of these authorities, *Shimman*, *Lamb Engineering & Construction Co.*, and *Towerridge, Inc.*, (Petition at 27), somehow support its contention that pre-litigation conduct can warrant an inherent authority attorney fee award is, at best, not well founded, and runs afoul of the admonition that "[i]f you don't have [a split] don't try to fake it . . . The Court will never grant cert because of a conflict without reading the cases carefully." S. Baker, *supra*, 33 Catholic Univ. L. Rev. at 619.

Susman v. Bank of Israel, 56 F.3d 450, 459-460 (2nd Cir. 1995) (Petition at 26-27), and *Perales v. Casillas*, 950 F.2d 1066, 1071 (5th Cir. 1992) (Petition at 27), also do not address, let alone hold, that pre-litigation misconduct can form the basis for an inherent authority fee award. Nor does *Guevara v. Maritime Overseas Corp.*, 59 F.3d 1496 (5th Cir. 1995) (Petition at 27). *Guevara* does no more than state that the four dissenting Justices in *Chambers* "were firmly of the view that bad faith fee shifting may not be used to sanction pre-litigation misconduct." *Id.* at 1503. The majority in *Chambers* was of the same view, concluding that an inherent authority sanction award did not present an *Erie* problem precisely because the sanction award was limited to litigation misconduct, and thus did not encroach on the applicable state law's prohibition against an attorney fee award for the conduct that formed the basis of the claims. 501 U.S. at 53. ("We agree with the Court of Appeals that we do not see how the district court's inherent power to tax fees for that conduct can be made

subservient to any state policy without transgressing the grounds of *Erie* . . . for fee-shifting here is not a matter of substantive remedy but of vindicating judicial authority"). *Accord* 10 Moore's Federal Practice, *supra* § 54.171[2][c][ii] at p. 54-266.

Equally unavailing is the Petition's reliance on *United States ex rel. Yonker Construction Co. v. Western Contracting Corp.*, 935 F.2d 936, 942 (8th Cir. 1991) (Petition at 27) for the proposition that pre-litigation conduct can support an inherent authority attorney fee award. This authority pre-dates *McLarty* and *Lamb*, and *Lamb* expressly held that it was "clarify[ing]" the holding in *Yonker Construction Co.*, and that attorneys' fees for pre-litigation misconduct are non-recoverable. 103 F.3d at 1434. The type of conflict the Court requires before it will grant *certiorari* simply does not exist here. *See generally* Stern, Gressman, Shapiro and Geller, Supreme Court Practice §§ 4.3 and 4.4 (8th ed. 2002).

B.

Chambers also teaches that "when there is bad faith conduct in the course of litigation that could be adequately sanctioned under the Rules [of Civil Procedure or statutes], the court should rely on [them] rather than the inherent power," for inherent power "exist[s] to fill in the interstices." 501 U.S. at 46, 50. Resort to inherent authority should be reserved for circumstances in which "neither the statute nor the Rules are up to the task," *id.* at 50, such as in *Chambers*, where, "much of the bad faith conduct by Chambers . . . was beyond the reach of the Rules; his entire course of conduct throughout the lawsuit evidenced bad faith and an attempt to perpetrate a fraud on the court. . . ." *Chambers* also stressed that the inherent authority doctrine cannot be used "as a means of circumventing the clear mandate of a procedural rule." 501 U.S. at 50-51. This is precisely what Judge Posner said, here.

Here, the district court did not explain why, let alone find, that Rule 11 was not "up to the task" of dealing with Lenell's Answer. It merely observed in passing that Rule 11 no longer "had fangs." (R. 122, Ex. 2, 11/19/2001 Tr. 2). But that is very different from *properly finding* that the Rule was inherently inadequate to cure the "harm" caused by the Answer. This attempt to substitute inherent authority for Rule 11 is prohibited by *Chambers* and *Corley v. Rosewood Care Center, Inc.*, 142 F.3d 1041 (7th Cir. 1998). That Zapata and the district court – which could have acted *sua sponte,* Rule 11 (c)(1) (A) and (B) to require correction of an improper denial – chose not to invoke the Rule, which would have limited damages to the minimal harm caused by the filing (i.e., less than $20,000.00) did not mean that the Rule was inadequate.

That Rule 11 was adequate to deal with the Answer (R. 4) is clear. Even prior to the Answer, Zapata had begun drafting requests to admit. Lenell's responses to them in November, 1999 were comprehensive and essentially admitted liability. (R. 10; 12 Ex. C-E; 27; 28 at 5-7).[11] The answers formed the basis of the motion for partial summary judgment made early in 2001, which stressed that Lenell had, as a matter of law, admitted $857,796.90 of the $890,243 sought in the Complaint! (R. 1 at 1; R. 27 at 5; R. 28; Tr. 866). The court concluded that these responses acknowledged virtually all the indebtedness.[12] According to Exhibit 4 to Zapata's October 31, 2001 Fee Petition, (R. 101) it incurred $14,580 for discovery related work prior to

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[11] Although Zapata moved to compel certain responses to the requests to admit, there was not a request for sanctions, and the court did not find that sanctions were appropriate. (R. 12). In any event, Rule 37 sanctions would have filled the bill.

[12] The court, *sua sponte*, denied the motion immediately, not because of any dispute about liability, but on the technical ground that Rule 56 did not authorize an appealable, enforceable judgment "for any portion of a claim less than the whole." (R. 55-3 at 2-5).

Lenell's January 2000 discovery responses. Obviously, Rule 11 was adequate to deal with any infraction related to the Answer, and no deficiency in it can justify an award of $550,000 in attorneys' fees covering every facet of the case.

The court's dissatisfaction with the preconditions to Rule 11's applicability – or perhaps its recognition that its and Zapata's failure to have invoked the Rule made it unavailable as a basis for sanctions, *Corley, supra*, 142 F.3d at 1058 – ignored the fact that the Rule's "procedural protections are intended to . . . provide opportunities for parties to avoid sanctions." *Perpetual Securities, Inc. v. Tang*, 290 F.3d 132, 141-42 (2nd Cir. 2002). Zapata's refusal to have invoked either Rule 11 or Rule 37 does not mean there was some "interstice" that could only be filled by an exercise of inherent authority. The only "interstice" in this case was the American Rule. But that is not the kind of gap *Chambers* had in mind.

The circuit courts of appeals have been faithful to this aspect of *Chambers*, and concluded that an inherent authority fee award is only appropriate when the Rules are "not up to the task." *See e.g. United States v. One 1987 BMW 325*, 985 F.2d 655, 661 (1st Cir. 1993) (Petition at 23); *Montrose Med. Group Sav. Plan v. Bulger, supra*, 243 F.3d at 785 (3rd Cir. 2001) (Petition at 24); *Mark Indus. Ltd. v. Sea Captain's Choice, Inc.*, 50 F.3d 730, 732 (9th Cir. 1995); *Hutchinson v. Pfeil*, 208 F.3d 1180, 1186-87 (10th Cir. 2000).

In fact, in no case cited in the Petition has a court departed from *Chambers*' holding that the inherent authority doctrine may never be employed unless the rules are "not up to the task" of sanctioning the misconduct. In *DLC Management Corp. v. Town of Hyde Park*, 163 F.3d 124 (2nd Cir. 1998) (Petition at 24), the court concluded that defendant's discovery violations could not be remedied under Rule 37 before entering an inherent authority

award. This was the reason the Second Circuit affirmed: "We affirm the district court's conclusion that the Report and Recommendation, as a whole, constituted a rational judicial effort to speak to the entire problem of the Defendants' discovery and neglect."

In re Weiss, 111 F.3d 1159, 1172 (4th Cir. 1997) (Petition at 24) affirmed an inherent authority sanction award because the "conduct sanctionable under the Rules was intertwined within conduct that only the inherent power could address. *Chambers*, 501 U.S. at 51." In *RTC v. Dabney*, 73 F.3d 262, 271 (10th Cir. 1995) (Petition at 25), the court awarded sanctions under the inherent authority doctrine precisely because it concluded that the award – an attorney fee award to the court for the time it wasted on a motion – was not allowable under 28 U.S.C. § 1927. Thus, § 1927 was not up to the task and the court needed to rely on its inherent authority.

In *Pickholtz v. Rainbow Technologies, Inc.*, 284 F.3d 1365 (Fed. Cir. 2002) (Petition at 25), the court concluded the inherent authority doctrine may be an appropriate basis for a sanction award in the case because Rule 37 was not up to the task. In *Pickholtz*, a Rule 37 motion was denied because it only authorizes attorneys' fees and the motion was brought by a pro se litigant. For this reason, Rule 37 was not "up to the task" and the Federal Circuit remanded the case to the district court to consider whether an inherent authority award was appropriate under the circumstances.

In *Thomas v. Tenneco Packaging Co.*, 293 F.3d 1306, 1320 (11th Cir. 2002) (Petition at 25), the court affirmed a district court order that censured and reprimanded a lawyer pursuant to the court's inherent powers for having accused another lawyer of having made racially derogatory remarks. The court held that while sanctions may have been possible under various Rules and statutes, the court was free to proceed under its inherent authority because a

court obviously has the authority to "censure" and "regulate" the attorneys who appear before it. Nothing in the opinion suggests that a massive blanket monetary award can be made by a district court in order to circumvent the requirements of Rules 11, 37 or 28 U.S.C. § 1927.

Nick v. Morgan Foods, Inc., 270 F.3d 590, 595, n.2 (8th Cir. 2001) stated in dicta that the Rules do not "replace or foreclose resort to the court's inherent power." It did not state that the inherent authority doctrine can be deployed absent a determination that the Rules "are not up to the task." *In re Mroz*, 65 F.3d 1567, 1576 (11th Cir. 1995) (Petition at 25), *Fink v. Gomez*, 239 F.3d 989, 994 (9th Cir. 2001) and *Travelers Ins. v. St. Jude Hospital,* 38 F.3d 1414, 1417 (5th Cir. 1994) (Petition at 25) also do not hold that a court can resort to its inherent authority without considering whether the Rules are up to the task. In fact, none of these authorities addressed this issue.

First Bank of Marietta v. Hartford Underwriters Insurance Co., 307 F.3d 501, 517 (6th Cir. 2002) (Petition at 24), which was authored by a district judge, also does not support granting the Petition. *First Bank of Marietta* held that, "[a]lthough *Chambers* states that a district court should consider whether the conduct could be sanctioned under the rules before it relies on its inherent authority . . . We do not interpret *Chambers* to require the district court in every instance to exhaust consideration of sanctions under other relevant rules and/or statutes. . . . We are reluctant to impose a wooden requirement where the district court needs the discretion and flexibility to exercise its inherent authority." 307 F.3d at 513, 514. However, the district court's findings did make clear that the Rules were not up to the task. 307 F.3d at 517. ("First Bank's Rule 11 misconduct is intertwined with its other misconduct that needed to be addressed by the district court's inherent powers"). Thus, the decision represents an inconsistency in dicta, that does not warrant this Court's

review, and a single non-outcome determinative concept from an opinion does not warrant *certiorari*. "An inconsistency in dicta" does not suffice. Stern, Gressman, Shapiro and Geller, *supra,* Supreme Court Practice at § 4.3.

This dicta, as pointed out by Circuit Judge Gilman's dissent, is wrong. First, it represents the only authority that has suggested that the Rules must not always be considered before the court may resort to the inherent authority doctrine. *See* 307 F.3d at 534. Second, constraining district courts by requiring them first to look to the Rules will not impermissibly hamper their discretion. It will only assure that the fee award is no greater than necessary to address the harm created, and that courts do not contravene the federal rules which "have the force of statutes." 313 F.3d at 392.

CONCLUSION

The Petition for *Certiorari* should be denied.

Respectfully submitted,

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UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (1980) (CISG)[1]

Article 1

(1) This Convention applies to contracts of sale of goods between parties whose places of business are in different States:

(a) when the States are Contracting States; or

(b) when the rules of private international law lead to the application of the law of a Contracting State.

(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.

(3) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention.

Article 7

(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be

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[1] For U.S. citation purposes, the UN-certified English text is published in 52 Federal Register 6262, 6264-6280 (March 2, 1987); United States Code Annotated, Title 15, Appendix (Supp. 1987).

settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

Article 74

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.

Article 75

If the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction as well as any further damages recoverable under article 74.

Article 76

(1) If the contract is avoided and there is a current price for the goods, the party claiming damages may, if he has not made a purchase or resale under article 75, recover the difference between the price fixed by the contract and the current price at the time of avoidance as well as any further damages recoverable under article 74. If, however, the party claiming damages has avoided the contract after

taking over the goods, the current price at the time of such taking over shall be applied instead of the current price at the time of avoidance.

(2) For the purposes of the preceding paragraph, the current price is the price prevailing at the place where delivery of the goods should have been made or, if there is no current price at that place, the price at such other place as serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods.

Article 77

A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated.

Section III. Interest

Article 78

If a party fails to pay the price or any other sum that is in arrears, the other party is entitled to interest on it, without prejudice to any claim for damages recoverable under article 74.

313 F.3d 385 (7th Cir. 2002)

ZAPATA HERMANOS SUCESORES, S.A.,
Plaintiff-Appellee,

v.

HEARTHSIDE BAKING COMPANY, INC.,
d/b/a Maurice Lenell Cooky Company,
Defendant-Appellant

NoS. 01-3402, 02-1867 and 02-1915.

United States Court of Appeals,
Seventh Circuit.

Argued Sept. 13, 2002.

Decided Nov. 19, 2002.

As Amended Dec. 17, 2002.

Javier H. Rubinstein (argued), Mayer, Brown, Rowe & Maw, Chicago, IL, for Plaintiff-Appellee.

Jeffrey N. Cole (argued), Cole & Staes, Chicago, IL, for Defendant-Appellant.

Before POSNER, DIANE P. WOOD, and EVANS, Circuit Judges.

POSNER, Circuit Judge.

Zapata, a Mexican corporation that supplied Lenell, a U.S. wholesale baker of cookies, with cookie tins, sued Lenell for breach of contract and won. The district judge ordered Lenell to pay Zapata $550,000 in attorneys' fees. From that order, which the judge based both on a provision of the Convention on Contracts for the International Sale of Goods, Jan. 1, 1988, 15 U.S.C. App., and on the inherent authority of the courts to punish the conduct of litigation in bad faith, Lenell appeals.

The Convention, of which both the U.S. and Mexico are signatories, provides, as its name indicates, remedies for breach of international contracts for the sale of goods. Zapata brought suit under the Convention for money due under 110 invoices, amounting to some $900,000 (we round liberally), and also sought prejudgment interest plus attorneys' fees, which it contended are "losses" within the meaning of the Convention and are therefore an automatic entitlement of a plaintiff who prevails in a suit under the Convention. At the close of the evidence in a one-week trial, the judge granted judgment as a matter of law for Zapata on 93 of the 110 invoices, totaling $850,000. Zapata's claim for money due under the remaining invoices was submitted to the jury, which found in favor of Lenell. Lenell had filed several counterclaims; the judge dismissed some of them and the jury ruled for Zapata on the others. The jury also awarded Zapata $350,000 in prejudgment interest with respect to the 93 invoices as to which Zapata had prevailed, and the judge then tacked on the attorneys' fees – the entire attorneys' fees that Zapata had incurred during the litigation.

Article 74 of the Convention provides that "damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach," provided the consequence was foreseeable at the time the contract was made. Article 7(2) provides that "questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law [i.e., conflicts of law rules]." There is no suggestion in the

background of the Convention or the cases under it that "loss" was intended to include attorneys' fees, but no suggestion to the contrary either. Nevertheless it seems apparent that "loss" does not include attorneys' fees incurred in the litigation of a suit for breach of contract, though certain pre-litigation legal expenditures, for example expenditures designed to mitigate the plaintiff's damages, would probably be covered as "incidental" damages. *Sorenson v. Fio Rito,* 90 Ill.App.3d 368, 45 Ill.Dec. 714, 413 N.E.2d 47, 50-52 (1980); cf. *Tull v. Gundersons, Inc.,* 709 P.2d 940, 946 (Colo.1985); *Restatement (Second) of Contracts* § 347, comment c (1981).

The Convention is about contracts, not about procedure. The principles for determining when a losing party must reimburse the winner for the latter's expense of litigation are usually not a part of a substantive body of law, such as contract law, but a part of procedural law. For example, the "American rule," that the winner must bear his own litigation expenses, and the "English rule" (followed in most other countries as well), that he is entitled to reimbursement, are rules of general applicability. They are not field-specific. There are, it is true, numerous exceptions to the principle that provisions regarding attorneys' fees are part of general procedure law. For example, federal antidiscrimination, antitrust, copyright, pension, and securities laws all contain field-specific provisions modifying the American rule (as do many other field-specific statutes). An international convention on contract law *could* do the same. But not only is the question of attorneys' fees not "expressly settled" in the Convention, it is not even mentioned. And there are no "principles" that can be drawn out of the provisions of the Convention for determining whether "loss" includes

attorneys' fees; so by the terms of the Convention itself the matter must be left to domestic law (i.e., the law picked out by "the rules of private international law," which means the rules governing choice of law in international legal disputes).

U.S. contract law is different from, say, French contract law, and the general U.S. rule on attorneys' fee shifting (the "American rule") is different from the French rule (loser pays). But no one would say that French contract law differs from U.S. *because* the winner of a contract suit in France is entitled to be reimbursed by the loser, and in the U.S. not. That's an important difference but not a contract-law difference. It is a difference resulting from differing procedural rules of general applicability.

The interpretation of "loss" for which Zapata contends would produce anomalies; this is another reason to reject the interpretation. On Zapata's view the prevailing plaintiff in a suit under the Convention would (though presumably subject to the general contract duty to mitigate damages, to which we referred earlier) get his attorneys' fees reimbursed more or less automatically (the reason for the "more or less" qualification will become evident in a moment). But what if the defendant won? Could he invoke the domestic law, if as is likely other than in the United States that law entitled either side that wins to reimbursement of his fees by the loser? Well, if so, could a winning plaintiff waive his right to attorneys' fees under the Convention in favor of domestic law, which might be more or less generous than Article 74, since Article 74 requires that any loss must, to be recoverable, be foreseeable, which beyond some level attorneys' fees, though reasonable ex post, might not be? And how likely is it that the United States would have signed the Convention had

it thought that in doing so it was abandoning the hallowed American rule? To the vast majority of the signatories of the Convention, being nations in which loser pays is the rule anyway, the question whether "loss" includes attorneys' fees would have held little interest; there is no reason to suppose they thought about the question at all.

For these reasons, we conclude that "loss" in Article 74 does not include attorneys' fees, and we move on to the question of a district court's inherent authority to punish a litigant or the litigant's lawyers for litigating in bad faith. The district judge made clear that he was basing his award of attorneys' fees to Zapata in part on his indignation at Lenell's having failed to pay money conceded to be owed to Zapata. Although the precise amount was in dispute, Lenell concedes that it owed Zapata at least half of the $1.2 million that Zapata obtained in damages (not counting the attorneys' fees) and pre-judgment interest. Lenell had no excuse for not paying that amount, and this upset the judge.

Firms should pay their debts when they have no legal defense to them. *Pacta sunt servanda,* as the saying goes ("contracts are to be obeyed"). In the civil law (that is, the legal regime of Continental Europe), this principle is taken very seriously, as illustrated by the fact that the civil law grants specific performance in breach of contract cases as a matter of course. But under the common law (including the common law of Illinois, which is the law that choice of law principles make applicable to any issues in this case not covered in express terms by the Convention), a breach of contract is not considered wrongful activity in the sense that a tort or a crime is wrongful. When we delve for reasons, we encounter Holmes's argument that practically speaking the duty created by a contract is really just to

perform or pay damages, for only if damages are inadequate relief in the particular circumstances of the case will specific performance be ordered. In other words, and subject to the qualification just mentioned, the entire practical effect of signing a contract is that by doing so one obtains an option to break it. The damages one must pay for breaking the contract are simply the price if the option is exercised. *See* Oliver Wendell Holmes, Jr., *The Common Law* 300-02 (1881); Holmes, "The Path of the Law," 10 *Harv. L.Rev.* 457, 462 (1897).

Why such lenity? Perhaps because breach of contract is a form of strict liability. Many breaches are involuntary and so inapt occasions for punishment. Even deliberate breaches are not necessarily culpable, as they may enable an improvement in efficiency – suppose Lenell had a contract to take a certain quantity of tins from Zapata and found that it could buy them for half the price from someone else. Some breaches of contract, it is true, are not only deliberate but culpable, and maybe this was one – Lenell offers no excuse for failing to pay for tins that it had taken delivery of and presumably resold with its cookies in them. Refusing to pay the contract price after the other party has performed is not the kind of option that the performing party would willingly have granted when the contract was negotiated. The option of which Holmes spoke was the option not to perform because performance was impossible or because some more valuable use of the resources required for performance arose after the contract was signed. Zapata argues, moreover, perhaps correctly (we need not decide), that Lenell refused to pay in an effort to extract a favorable modification of the terms of the parties' dealings, which would be a form of duress if Zapata somehow lacked an effective legal remedy. *Professional*

Service Network, Inc. v. American Alliance Holding Co., 238 F.3d 897, 900-01 (7th Cir.2001); *Alaska Packers' Ass'n v. Domenico*, 117 F. 99, 100-04 (9th Cir.1902). But Zapata did not charge duress, and probably couldn't, since it had a good remedy – this suit.

It is true that nowadays common law courts will sometimes award punitive damages for breach of contract in bad faith. But outside the field of insurance, where refusals in bad faith to indemnify or defend have long been punishable by awards of punitive damages to the insured, the plaintiff must show that the breach of contract involved tortious misconduct, such as duress or fraud or abuse of fiduciary duty. *See*, e.g., *Miller Brewing Co. v. Best Beers of Bloomington, Inc.*, 608 N.E.2d 975, 982-83 (Ind.1993); *Story v. City of Bozeman*, 242 Mont. 436, 791 P.2d 767, 776 (1990); E. Allan Farnsworth, *Contracts* § 12.8, pp. 788-89 (3d ed.1999). This is the rule in Illinois, *Morrow v. L.A. Goldschmidt Associates, Inc.*, 112 Ill.2d 87, 96 Ill.Dec. 939, 492 N.E.2d 181, 183-86 (1986), and Zapata has not tried to come within it. For that matter, it did not ask for punitive damages, and the judge had no authority to award attorneys' fees in lieu of such damages. He could not have awarded punitive damages if Zapata had asked for them but had been unable to prove tortious misconduct by Lenell, and even more clearly he could not award them when they had not been requested.

The decision whether punitive damages shall be a sanction for a breach of contract is an issue of substantive law, and under the *Erie* doctrine a federal court is not authorized to apply a different substantive law of contracts in a diversity case from the law that a state court would apply were the case being litigated in a state court instead. And obviously that rule must not be circumvented

by renaming punitive damages "attorneys' fees." *United States ex rel. Treat Bros. Co. v. Fidelity & Deposit Co. of Maryland,* 986 F.2d 1110, 1119-20 (7th Cir.1993); *see* also *Chambers v. NASCO, Inc.,* 501 U.S. 32, 52-55, 111 S.Ct. 2123, 115 L.Ed.2d 27 (1991); *Association of Flight Attendants, AFL-CIO v. Horizon Air Industries, Inc.,* 976 F.2d 541, 548-50 (9th Cir.1992). It is true that this is not a diversity case, but the *Erie* doctrine applies to any case in which state law supplies the rule of decision, *see*, e.g., *O'Melveny & Myers v. FDIC,* 512 U.S. 79, 83-85, 87-88, 114 S.Ct. 2048, 129 L.Ed.2d 67 (1994), here by incorporation in the Convention.

The inherent authority of federal courts to punish misconduct before them is not a grant of authority to do good, rectify shortcomings of the common law (as by using an award of attorneys' fees to make up for an absence that the judge may deem regrettable of punitive damages for certain breaches of contract), or undermine the American rule on the award of attorneys' fees to the prevailing party in the absence of statute. *Morganroth & Morganroth v. DeLorean,* 213 F.3d 1301, 1318 (10th Cir.2000); *Association of Flight Attendants, AFL-CIO v. Horizon Air Industries, Inc., supra,* 976 F.2d at 548-50 (9th Cir.1992); *Shimman v. International Union of Operating Engineers, Local 18,* 744 F.2d 1226, 1232-33 and n. 9 (6th Cir.1984) (en banc). These cases and others we could cite make clear that it is a residual authority, to be exercised sparingly, to punish misconduct (1) occurring in the litigation itself, not in the events giving rise to the litigation (for then the punishment would be a product of substantive law – designed, for example, to deter breaches of contract), and (2) not adequately dealt with by other rules, most pertinently here

Rules 11 and 37 of the Federal Rules of Civil Procedure, which Lenell has not been accused of violating.

Insofar as he focused on Lenell's behavior in the litigation itself, which, to repeat, is the only lawful domain of the relevant concept of "inherent authority" – the authority could not constitutionally be extended to give parties remedies not available to them under the law of the state that furnishes the substantive rules of decision in the case – the judge punished Lenell for having failed to acknowledge liability and spare Zapata and the judge and the jury and the witnesses and so on the burden of a trial. But as it happens, the fault here was in no small measure the judge's. Well before the trial, and long, long before Zapata's lawyers had run the tab up to $550,000, they had moved for partial summary judgment, claiming that Lenell in answer to Zapata's requests for admission had acknowledged liability for $858,000 of the $890,000 sought in the complaint. The judge had denied the motion on the ground that partial summary judgment cannot be granted unless the grant would give rise to an appealable judgment. This was error. Rule 56(d) of the civil rules is explicit in allowing the judge to grant summary judgment on less than the plaintiff's whole claim, and there is no hint of any requirement that the grant carve at a joint that would permit the judge to enter a final judgment under Rule 54(b). If the plaintiff had two separate claims, and the judge granted summary judgment on one and set the other for trial, he could also if he wanted enter final judgment on the first dismissal, enabling the defendant to appeal immediately under Rule 54(b). If instead the plaintiff had as here one claim, and the judge granted it in part, the defendant could not appeal – the conditions of Rule 54(b) would not be satisfied – yet it is evident from

the wording of Rule 56(d) that this would be a proper partial summary judgment, for the rule expressly authorizes an order "specifying the facts that appear without substantial controversy, including the extent to which the amount of damages or other relief is not in controversy." No purpose would be served by confining the rule as the district judge did. If anything, judicial economy is better served by a partial summary judgment that is *not* appealable, since a Rule 54(b) appeal normally interrupts the proceedings in the district court.

Since the challenged award of $550,000 in attorneys' fees cannot stand, we need not pick through the record to see whether some of the counterclaims or other moves by Lenell during the trial were sanctionable apart from Rule 11 and Rule 37. But it may be useful in guiding further proceedings on remand to point out that to the extent that those rules place limits on the award of sanctions under them (for example by the provision of safe harbors in Rule 11), those limitations are equally limitations on inherent authority, which may not be used to amend the rules. *Kovilic Construction Co. v. Missbrenner,* 106 F.3d 768, 772-73 (7th Cir.1997). For federal rules of procedure have the force of statutes. *See id.;* 28 U.S.C. § 2072(b).

One issue remains for discussion. Although we have treated the appeal so far as if the only issues concerned attorneys' fees, Lenell also argues that the jury verdict should be set aside because the judge by his comments in open court signaled to the jury his scorn for Lenell's case. There were only a couple of such comments (many more, however, at sidebars outside the jury's hearing), and we do not think they could have changed the outcome. But we also think that judges should be very cautious about making comments in the hearing of a jury about the

quality of a party's case or lawyers. For if he signals to the jury his opinion as to how the case should be decided, he undermines the jury's authority. *Collins v. Kibort,* 143 F.3d 331, 336 (7th Cir.1998); *Nationwide Mutual Fire Ins. Co. v. Ford Motor Co.,* 174 F.3d 801, 805, 808 (6th Cir.1999); *see* also *Ross v. Black & Decker, Inc.,* 977 F.2d 1178, 1187 (7th Cir.1992).

From what we have just reported about the judge's statements during the trial and from the tone of a number of other statements that he made in the course of this litigation, we think it best that the further proceedings that we are ordering be conducted before a different judge, in accordance with 7th Cir. R. 36.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.